

***United States Court of Appeals  
for the Second Circuit***



**APPELLANT'S  
BRIEF**





# 76-5014

## United States Court of Appeals FOR THE SECOND CIRCUIT

In the Matter of

ALRAC CORPORATION f.d.b.a.,  
RADIATION RESEARCH CORPORATION  
f.d.b.a., THE ALRAC COMPANY,

*Debtor.*

CARL E. BARNES,

*Appellant,*

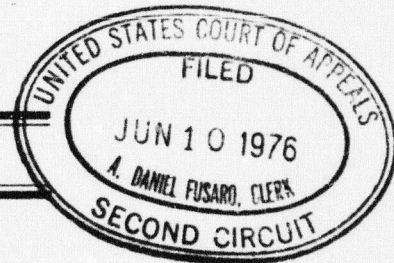
*v.*

ALRAC CORPORATION,

*Debtor-Appellee.*

ON APPEAL FROM THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF CONNECTICUT

### APPELLANT'S BRIEF



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ISSUES PRESENTED FOR REVIEW

1. Did the District Court err in finding that the Bankruptcy Judge correctly held

- a) That the plan had been accepted by the requisite majority of creditors.
- b) That the classification of creditors was proper.
- c) That the modification of the plan was not material.
- d) That the plan was in the best interests of the creditors.
- e) That the plan was feasible.

2. Are the findings by the bankruptcy judge - that the Chapter XI plan of Alrac Corporation was (a) accepted by the requisite majority of each class of unsecured creditors affected thereby and (b) for the best interests of creditors and feasible - clearly erroneous?

3. Did the District Court err in finding the provisions of the plan were appropriate to Chapter XI rather than Chapter X and that the Bankruptcy Judge properly denied the petition to transfer the proceeding from Chapter XI to Chapter X.

4. Did the bankruptcy judge abuse his discretion in finding that the needs of Alrac were adequately served by the provisions of Chapter XI of the Bankruptcy Act and, therefore, that conversion of the case to Chapter X of the Bankruptcy Act was not proper?

STATEMENT OF THE CASEPreliminary Statement

Carl E. Barnes (hereinafter "Barnes") appeals from a judgment entered on February 23, 1976 in the United States District Court for the District of Connecticut. (A471.)

Debtor-Appellee Alrac Corporation (hereinafter "Alrac") petitioned in a pending proceeding in the District Court for an arrangement pursuant to Chapter XI of the Bankruptcy Act. On December 30, 1974, Bankruptcy Judge Saul Seidman dismissed a petition by Barnes to transfer the proceeding to a Chapter X reorganization. (A299.) On December 31, 1974, Judge Seidman confirmed Alrac's plan as modified. (A315.)

Barnes appealed from both orders of Bankruptcy Judge Seidman. During the pendency of the appeals, an amendment was made. (A319.) In an unreported Ruling on the appeals, Chief Judge T. Emmet Clarie affirmed the orders of Bankruptcy Judge Seidman. (A462.) He held that the Bankruptcy Judge had made no clearly erroneous findings of fact and had not abused his discretion either in denying the petition to transfer the



proceeding from Chapter XI to Chapter X or in confirming the plan of arrangement.

On this appeal Barnes contends that the provisions of the plan were appropriate to Chapter X rather than Chapter XI, and that the plan should not have been confirmed because it was not accepted by the requisite majority of creditors, was materially modified without resubmission to the creditors, was infeasible, and was not in the best interests of the creditors.

#### Statement of Facts

Barnes is a creditor of Alrac, having filed proofs of claim on November 20, 1974 in the amount of \$2,083.50 as a priority claim, \$72,900.00 for salary and \$400,000.00 as a contingent claim. The \$400,000.00 contingent claim was based upon Barnes' guaranty of Alrac's notes to Hartford National Bank. (A331.) The bank has proceeded against Barnes by commencing foreclosure proceedings on mortgages given by Barnes to secure his guarantee. (Id.; A376.) Barnes' contingent claim was superseded when the bank filed a claim, itself. This was done on January 31, 1975, during the pendency of the appeals to the District Court. (A331.) Barnes is also

the largest stockholder of Alrac, owning 209,000 shares of common stock.

Barnes, a Ph.D. in Chemistry, is a chemical engineer and inventor of long experience. For 25 years he has been engaged, on and off, in the development of Nylon-4. Nylon-4, a synthetic, constitutes a substantial improvement over Nylon-6, the current standard raw material used for manufacture of synthetic textiles and plastics. Unlike Nylon-6, Nylon-4 has a high moisture absorbency characteristic; it "breathes" in the same degree and manner as cotton; is static-free and has superior dyeability, abrasion resistance, ironability, wrinkle-resistance and shape recoverability. Nylon-4 has a major raw material cost advantage in that it is made from more plentiful and cheaper petroleum products and is completely and inexpensively recycled.

In 1968, Barnes' application for a patent for a Nylon-4 process was filed with the United States Patent Office. In the same year he was the prime mover in the formation of a New York corporation under the name of Alrac Company. Harvey Wolfe, Herb Oscar Anderson and Barnes were the stockholders of Alrac Company, which became the assignee of Barnes' Nylon-4 patents. The corporation was formed for the initial purpose of perfecting Nylon-4 and as an ultimate vehicle for its ex-



exploitation. By December of 1968, principally under the impetus of a need for financing, Alrac Company merged with Radiation Research Corporation, a publicly held Delaware corporation. In approximately December of 1970, the name of Radiation Research Corporation was changed to Alrac Corporation. It is this Alrac Corporation, the publicly held Delaware corporation, that is the Debtor-Appellee herein.

In 1969, subordinated debentures in the amount of \$3,000,000 were issued by Alrac. Such debentures, registered with the Securities and Exchange Commission (hereinafter the "SEC"), were sold primarily through the offices of Sterling Grace & Co. The subordinated debentures are subject to a trustee debenture agreement. During 1971 and 1972, further borrowings in the amount of \$580,000 were undertaken by Alrac in the form of convertible notes at 8-1/2% interest. The convertible notes were issued to approximately 55 people. Such financing was handled primarily by Mr. William Ferguson, a director of Alrac. Barnes placed two of such notes. During 1973 and January of 1974, approximately \$1,100,000 was raised on short term notes, having terms from one to nine months at various rates of interest, issued by Alrac.

By January, 1974, Alrac had acquired a pilot plant at 648 Hope Street, Stamford, Connecticut. Approximately

\$8,500,000 had been expended in the development of Nylon-4, which was then protected in the United States by 16 patents and patent applications with patent protection in 22 foreign countries. The most important patent pertaining to a stable product (hereinafter the "basic patent") was issued in 1973. This and the other patents and patent applications on related products have been assigned to Alrac.

Alrac was, in January of 1974, operating a research and development company with insufficient cash income. Alrac's then current needs approximated \$100,000 per month. (A176.) In the fall of 1973, a determination was made by Alrac's Board of Directors that they should seek acquisition by a major corporation. (A180.) A Mr. Fiske was retained to approach various companies with a finder's fee to be paid for successful effort. (A181.) Chevron Research Company, a subsidiary of Standard Oil of California with which Alrac had had some negotiations two years previously, was contacted by Mr. Fiske on the subject of acquiring Alrac. (Chevron Research Company and Chevron Chemical Company, another subsidiary, will both be referred to hereinafter as "Chevron".) Chevron's interest developed rapidly and a technical assistance agreement was signed between Chevron and Alrac in February, 1974. (A183-A184.) Barnes dissented from the decision of the Board to



sign such technical assistance agreement. Further negotiations were pursued with Chevron primarily through the efforts of Harvey Wolfe, a director and secretary of Alrac. As a result of such negotiations, a "closing agreement" was signed by Alrac and Chevron on April 24, 1974. (A184.) Barnes vigorously disagreed with his fellow Board members concerning signing of the "closing agreement" but was persuaded by Harold Hestnes, of Hale & Dorr, counsel for the corporation, and Harvey Wolfe, also an attorney, that he must sign a "closing agreement" as the chief executive officer of Alrac. (A185.)

The "closing agreement" in substance provided for the assignment by Alrac to Chevron of all of Alrac's patents, including the basic patent, with no license back to Alrac in the North American Continent (United States, Mexico and Canada) for any fiber use of Nylon-4. A license back in foreign countries with right to sub-licence was granted to Alrac for six years after execution of the "closing agreement." It was the opinion of Alrac's counsel at that time, Hale & Dorr, that since a disposition of substantially all of Alrac's assets was involved, approval of a majority of the stockholders was required under applicable Delaware corporation law. (A199-A201.) The "closing agreement" provided that it was to be submitted to creditors for approval and to the stockholders

of Alrac for approval at a general stockholders' meeting. (A200.) No annual meeting of stockholders had been held for the past two years, and the Debtor has strenuously opposed the calling of a stockholders' meeting during the pendency of the arrangement proceedings. If the "closing agreement" was approved, Chevron agreed to pay \$450,000 to Alrac in the first year and \$500,000 each succeeding year to the year 1990. Royalties of 2% were to be due from Chevron with payments as described above to be offset against such royalties. Chevron would license back to Alrac the right to manufacture certain non-woven Nylon-4 products. Such non-woven products had not been developed by Alrac as of August, 1974. (A215.)

Dr. Barnes' objections to the Chevron agreements were based on the following factors:

It would take approximately six years for Chevron to build and get into production a Nylon-4 plant which would produce a sufficient supply of the raw product to permit the manufacture and sale of Nylon-4 at a competitive price with existing synthetics. In the interim, Alrac, even if it was able to develop non-woven products, would not be able to obtain raw material at a price which would permit the Debtor to manufacture and sell such products at a competitive price. In reality, Chevron would acquire all of Alrac's patents and



know-how at no expense to Chevron since all fixed payments under the "closing agreement" would be a first charge on royalties otherwise becoming due. Alrac's ability to license Nylon-4 overseas would be illusory since no plant could be built here or overseas to produce a sufficient quantity of raw material within approximately six years, the period of Alrac's exclusivity. Alrac would not be able to sell licenses to foreign companies which would expire almost simultaneously with the availability of sufficient raw material to render the product commercially feasible. (A109-A110.)

As a result of Barnes' inability to support the Chevron agreement, he resigned as a director and Chairman of the Board in June, 1974. (A198.) His employment as President of Alrac was terminated in mid July, 1974 due to his opposition to the Chevron agreements. (Id.)

Although Chevron had obligated itself under the technical assistance agreement to pay to Alrac \$50,000 per month, in July, 1974 it unilaterally reduced such payments to \$20,000 per month and on August 5, 1974 threatened to terminate such payments altogether.

Alrac's Board of Directors prepared proposed proxy statements and scheduled the calling of an annual stockholders' meeting for various dates in 1974, the last of which was



scheduled for August 24, 1974. A proposed proxy statement was prepared (A199) and approved by the SEC but never forwarded to the stockholders due to a demonstration by creditors and stockholders that they would not approve the "closing agreement." Faced with the termination by Chevron of payments to it in breach of the technical assistance agreement, on August 14, 1974 Alrac abandoned its intention to obtain stockholder approval for the assignment of its principal asset to Chevron and entered into an exclusive license agreement and two related agreements with Chevron. The August 14th license agreement granted to Chevron an exclusive license of the Nylon-4 basic patent in the North American Continent. Such exclusive license was not conditioned upon stockholder approval, nor was stockholder approval ever sought or obtained. It was, however, based on Alrac filing a Chapter XI petition. (A16.)

In August, 1974, Barnes retained counsel to file a Chapter X petition. Instead of preparing a Chapter X petition, such counsel prepared an involuntary petition in bankruptcy which Barnes signed without knowing that it was an involuntary petition as opposed to a petition for reorganization under Chapter X of the Act. (A136-A137.) Such involuntary petition was filed on August 12, 1974. Alrac did not learn of the filing under after the execution of the contracts with



Chevron on August 14, 1974. (A378.) It filed its Chapter XI petition, required by the agreements with Chevron, six days later.

As of August 20th, the date on which its petition for an arrangement was filed, the Debtor represented its total debts to be \$5,247,285.70 and its assets to be \$45,615.34. Such listing of assets did not include Alrac's patents which are carried on Schedule B-2 (Personal Property of Debtor) annexed to the petition for arrangement at a value of \$1.00. Such schedule notes that the true value of such patents could exceed \$8,000,000. At the time of the filing of the petition, Alrac had already entered into the agreements with Chevron pursuant to which Chevron would pay approximately that amount in minimum payments if the agreements were not terminated prematurely.

As of August 20, 1974, there were 1,043,056 shares of Alrac's Common Stock held by 1,600 members of the public. Barnes, the owner of 209,000 shares, held the largest block of stock, just over 20%. As of such date there were also outstanding in the hands of public investors securities of Alrac consisting of short term notes, in the amount of approximately \$1,467,000; 8-1/2% Senior convertible notes on which Alrac owed \$683,972.38 (with interest to August 1, 1974); and



7-1/2% Convertible Subordinated Debentures in the aggregate amount of \$2,215,000. The short term notes and senior convertible notes are registered in the names of approximately 65 persons and were offered by Alrac without registration under the Securities Act of 1933. The common stock and the convertible subordinated debentures are traded in the over-the-counter market. There are warrant rights outstanding which can be converted. (A162.) All of Alrac's debt securities are in default.

Pursuant to notice dated August 20, 1974, a hearing was held before the Hon. Saul Seidman, Bankruptcy Judge, on August 26, 1974 on the application of Alrac to adopt and affirm the three agreements between Alrac and Chevron entered into on August 14, 1974. (A11-A15.) These agreements were a license agreement, an interim consulting agreement, and a suspension agreement. The interim consulting agreement provided for the payment by Chevron to Alrac of \$20,000 per month for consulting services to be rendered by Alrac to Chevron in the development of Nylon-4 during the pendency of the Chapter XI case. As a result of the resumption of payments by Chevron to Alrac, Harvey Wolfe, the Executive Vice-President of Alrac and the chief proponent among Alrac's officers of the arrangement with Chevron, has commenced to collect a salary of \$36,000 per year.



Pursuant to the license agreement, Alrac granted to Chevron and its affiliates and exclusive license and sub-licensing rights for the manufacture, use and sale of Nylon-4 and products made from Nylon-4 in the United States, Canada and Mexico, and to use and sell Nylon-4 and products made from Nylon-4 throughout the world, and a non-exclusive license, without the right to grant the sub-licenses, to manufacture, sell and use Nylon-4 and products made from Nylon-4 throughout the world, exclusive of the United States, Canada and Mexico. Pursuant to such license agreement, there was reserved to Alrac the right to manufacture Nylon-4 in the United States, Canada and Mexico for use by Alrac in the production of certain non-fiber finished Nylon-4 products, which right was to be exclusive until April 1, 1980 and non-exclusive thereafter, and as to other Nylon-4 non-fiber products, to be exclusive until April 1, 1984 and thereafter non-exclusive. Chevron undertook to make equal annual minimum royalty prepayments to Alrac in the amount of \$500,000, commencing January 1, 1977 through and including January 1, 1999, to be applied against a schedule of royalties set forth in the license agreement (at 2% of net sales).

The suspension agreement, executed on August 14, 1974, suspended until December 31, 1974 the implementation



and consummation of the "closing agreement" dated April 24, 1974. The suspended obligations were to be reinstated if no order of confirmation of the arrangement which Alrac was to propose in the Chapter XI proceeding was obtained on or before December 10, 1974 or in the event of a prior adjudication in bankruptcy or dismissal of the proceedings.

An application of Alrac to permit Debtor to borrow \$6,500 from Chevron on a certificate of indebtedness, creating a lien upon all the property of Alrac, was also heard at that time. Such hearing was continued to September 6, 1974 before Bankruptcy Judge Seidman. No notice of a first meeting of creditors had been given in the bankruptcy proceeding as of September 6, 1974, nor had any proofs of claim been filed in this proceeding. At such hearing on September 6th, Bankruptcy Judge Seidman, on the nomination of a Charles Kish who had filed no proof of claim as of that date, "constituted the committee as read by Mr. Brownstein" as the official Creditors' Committee. The "committee" as read by Mr. Brownstein was composed of individuals who had been designated as members of an informal creditors' committee at a meeting held in the offices of the First National City Bank in New York on the 5th day of September, 1974. Notice to all creditors of such informal meeting on September 5, 1974 had



not been given, nor was any opportunity afforded at such informal meeting to challenge or vote upon individuals designated for membership on such informal committee. Since no proofs of claim had been filed herein by September 6, 1974, no opportunity was afforded to any interested party to challenge the standing of any proposed member of such informal creditors' committee, nor was an opportunity afforded to creditors to vote on such committee at the hearing on September 6, 1974. The Chairman of such purported creditors' committee was David Wakeman, a director of the Debtor.

Barnes filed an answer in opposition to the Debtor's application to adopt and affirm the three contracts dated August 14, 1974 between the Debtor and Chevron. (A22-A25.) Payments to Alrac by Chevron under the Interim Consulting Agreement were conditioned upon the approval of such Agreement by the Bankruptcy Court within five days after the filing of the Chapter XI petition. This time was extended by Chevron to September 6, 1974, but no farther. Faced with this deadline, Bankruptcy Judge Seidman approved the agreements.

By an amended order filed on September 12, 1974, Bankruptcy Judge Seidman ordered that the three above-described contracts dated August 14, 1974 could be adopted and affirmed by the Debtor, and ratified such adoption and



affirmation. (A26 -A27 .)

Thereafter, the purported creditors' committee met on various occasions, each of which meetings was attended by Gerald W. Brownstein, the attorney for Alrac, and by Harvey Wolfe, the then Executive Vice-President of Alrac.

Ultimately, a plan of arrangement was proposed and filed by Alrac on November 1, 1974 and was modified by a substitute plan filed on November 20, 1974. (A28 -A38 .)

The plan of arrangement, as modified on November 20, 1974, divided the creditors into three classes, as follows:

Class I Creditors	All persons or companies having supplied merchandise or services and who have claims up to \$20,000.
Class II Creditors	All persons or companies having supplied merchandise or services and who have claims in excess of \$20,000 and/or are holders of short term notes and are holders of senior notes.
Class III Creditors	All persons or companies having subordinated convertible debentures.

On November 20, 1974, Barnes filed his amended claim in the amount of \$74,983.50 for wages due Alrac, of which amount \$2,083.50 constituted a priority claim, and his amended claim in the amount of \$400,000 for the contingent indebtedness of Alrac arising from Barnes' guaranty of Alrac's



obligations to Hartford National Bank.

By notice dated November 1, 1974, a first meeting of creditors was scheduled for November 22, 1974 before Bankruptcy Judge Seidman and a further hearing was scheduled for December 6, 1974 to determine whether or not the plan of arrangement filed by Alrac was accepted by the creditors. December 20, 1974 was fixed as the time, and the Bankruptcy Court in Hartford as the place, for the filing of objections to confirmation. On November 26, 1974, Barnes served and filed objections to the classification of creditors in the arrangement, pursuant to Section 351 of the Bankruptcy Act and on November 19, 1974, Barnes served and filed his objections to the plan of arrangement.

On December 10, 1974, an order to show cause was issued by Bankruptcy Judge Seidman upon the motion of Carl E. Barnes and Sarah E. Barnes, directing the Debtor to show cause on December 20, 1974 why an order should not issue pursuant to Section 328 of the Bankruptcy Act dismissing Alrac's petition for an arrangement and dismissing the Chapter XI proceeding, unless within such time as might be fixed by the Court, Alrac's petition was amended to comply with the provisions of Chapter X of the Bankruptcy Act.

On December 17, 1974, Barnes filed a complaint objecting to the confirmation of Alrac's arrangement as filed with the Court and served upon counsel for Alrac a written



request for the appearances of officers and the production of records of Alrac at the continued hearing to determine acceptance of the arrangement on December 20, 1974.

At the continued first meeting of creditors on December 20, 1974 before the Bankruptcy Court, Alrac presented to the Court its computation of creditors' acceptances of the arrangement filed by Alrac. (A89 -A106.) Such computation represented that it had been prepared after a review of the Court's records. (A89 .) Several of the claims which were represented as having been filed were not recorded in the Court's records as having been filed until after December 20, 1974. (For example, claims of Serico Electric Co., Inc. [hereinafter "Serico"] and Mitsubishi International Corporation [hereinafter "Mitsubishi"]). Compare A92 to A88. The proof of claim forms are at A79 -A82 .)

There is no indication in the record of proceedings in the Bankruptcy Court on December 20, 1974 as to the location of these claims on that date, other than the representation and implications that the claims relied upon by Alrac in its computations had already been filed. On December 23, 1974, they were marked "Received" by the Bankruptcy Court. However, in argument before the District Court, counsel for Alrac admitted that these disputed claims were in the possession of Co-Counsel for the Creditors' Committee during the proceedings and were not submitted to the Clerk of the



Bankruptcy Court until after the proceedings in the Bankruptcy Court had been concluded on December 20, 1974. (A404-A405.) Even as to this, there is no evidence in the Record.

Alrac's amended computation of Class I creditors includes 30 affected creditors' claims, totalling \$61,865.83\*, as "voting in favor" of the arrangement. Of these, 27, amounting to \$21,554.79\*, were filed before December 20, 1974. Three affected creditors' claims totalling \$40,311.04 were listed by Alrac but were not filed until after December 20, 1974. Alrac listed, as "not voting in favor," claims of thirteen affected creditors totalling \$25,617.93\*. All of these claims were filed before December 20, 1974. Alrac did not include, in any of the three classes of claims, three creditors' claims, totalling \$4,439.28, which were not listed as priority claims and were filed before December 20, 1974. Also excluded were two creditors from whom telegrams of withdrawal were received but no proofs of claim had actually been docketed prior to the proceedings on December 20, 1974. (A57 -A58 .)

Although Barnes' contingent claim in the amount of \$400,000 does not fit into any of the three classifications of creditors defined in the plan, such claim was included by the creditors' committee in Class II. (A58 .)

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\* These figures were obtained from Alrac's computations by excluding claims of less than \$100. Such claims should not have been included, since the arrangement cannot affect such claims.

At the hearing held on December 20, 1974, counsel for Alrac failed to produce copies of a letter of solicitation of consents sent to creditors by the creditors' committee, although previously requested to do so by Barnes' counsel. (A54 ; A59 .) The letter of solicitation sent to Class I creditors by the creditors' committee failed to apprise such Class I creditors that Class II and III creditors were receiving stock as well as one hundred per cent payment of their claims. The combined proof of claim and acceptance which was sent out by the creditors' committee was misleading since the proof of claim and consent appeared to permit execution of the proof of claim only if a consent was also signed by the creditor, there being only one signature line appearing below the consent.

Prior to the hearing of December 20th, Barnes' counsel had not had an opportunity to examine the acceptances considered by the court since they were in the possession of the creditors' committee. (A51 .) Regardless of this, Barnes' counsel's repeated request for a reservation of his right to examine the claims and acceptances, in an appropriate circumstance, was denied by the Bankruptcy Court. (A59 -A64 .) The objecting creditor was given sixty-four (64) minutes in which to conduct examination of the claims and acceptances. This did not afford Barnes reasonable opportunity to analyze the claims and acceptances included or not included in Alrac's computation, since the first meeting of creditors was closed



by the Bankruptcy Court minutes thereafter. (A65.) The Bankruptcy Court then scheduled a hearing on confirmation of Alrac's arrangement and on Barnes' application to transfer the proceeding to a Chapter X reorganization for December 26, 1974.

On December 26, 1974 a hearing was conducted by the Bankruptcy Court on confirmation of Alrac's arrangement and Barnes' application to transfer the proceeding to a Chapter X reorganization. On that date Alrac submitted a proposed amendment to the plan of arrangement. (A297.) This amendment provided that the shares of Alrac stock issued to Class II and Class III creditors should bear a legend reciting that the stock had not been registered under the Securities Act of 1933. The legend further stated that no sale, transfer or assignment could be made unless a registration statement is in effect or an exemption is available.

The proposed amendment to the plan further provided for Alrac to use its best efforts in effecting registration of the certificates. No notice of such proposed amendment to the plan of arrangement had been given to the creditors prior to the hearing on acceptances on December 20, 1974. David Grace, a witness called by Alrac as a financial expert, testified that legending the stock would depreciate its value by 50%; i.e. from 12-1/2¢ to 6-1/4¢ at the time of such testimony. (A294.)

As had been the case in September, on December 26, 1974 the Bankruptcy Court was faced with a very short deadline from Chevron: action was required by the end of the month. (A118; A249.) It was in this context that the Bankruptcy Court made its orders, rejecting the transfer to Chapter X and confirming the plan, on December 30 and 31, 1974 respectively. These are the orders from which Barnes appealed to the District Court and from an affirmance of which he appeals to this Court.

At the hearing before the District Court, counsel for Alrac disclosed that Alrac had entered into a new line of business, completely unrelated to Nylon-4, and was spending some of the funds being received from Chevron in these new pursuits.

#### ARGUMENT

##### POINT I

##### THE CLAIMS OF SERICO AND MITSUBISHI WERE IMPROPERLY COUNTED IN COMPUTING ACCEP- TANCES AT THE CREDITORS' MEETING

##### A. Claims Which Have Been Allowed Are Properly Counted in Computing Acceptance of a Plan.

When a Chapter XI arrangement has been proposed to creditors, it may not be confirmed unless it has been accepted in writing by all creditors (Bankruptcy Act §361), or



unless

"it has been accepted in writing by a majority in number of all creditors or, if the creditors are divided into classes, by a majority in number of all creditors of each class, affected by the arrangement, whose claims have been proved and allowed before the conclusion of the meeting, which number shall represent a majority in amount of such claims generally or of each class of claims, as the case may be;" Bankruptcy Act §362(1).

Only acceptances and non-acceptances by creditors whose claims have been both proved and allowed before the conclusion of the meeting may be considered.

The determination must be made as of an exact moment in time, namely the moment of conclusion of the creditors' meeting.

"The critical date is that of the conclusion of the creditors' meeting. §362(1). Claims allowed at this time may vote for or against the plan. A snapshot is taken, as it were, of creditor status and rights at this time. The vote is taken in accordance with this snapshot and, absent fraud, this vote is conclusive. Claims subsequently filed may not vote for or against the plan." In re Graco, Inc., 267 F. 2d 952, 955 (D. Conn. 1967).

This case was concerned with the effect of subsequent disallowance of claims which had been permitted to vote for or against the arrangement. It denied effect to later events.



"Once the meeting concludes, the vote taken there, absent fraud, is binding at all later stages of the proceeding, regardless of later allowance or disallowance of claims." Id., at 956.

An older case reaching the same conclusion is Miller's Apparel, Inc. v. H. Simonoff & Son, Inc., 29 F. 2d 507 (1st Cir. 1928). There, a majority in number and amount of creditors whose claims were proved and allowed filed assents to the composition. The meeting was closed. Following the meeting, while the clerk was preparing the referee's report, additional claims trickled in; they were filed and were allowed, if proper. Upon recomputing to include these claims, the majority failed to assent. The referee refused to recommend the composition, but was reversed by the Court of Appeals.

Judge Augustus N. Hand similarly disapproved of the practice of counting claims received by the referee after the creditors' meeting had closed.

"In my opinion, the claims of all creditors that are to be counted in consideration of the composition should be proved before the meeting called for that purpose is finally closed." In re Chinese Fur Importers, Inc., 269 F. 669, 670 (S.D.N.Y. 1921).

Case law stretching back over fifty years thus confirms the clear command of the Bankruptcy Act: only claims which have been proved and allowed before the conclusion of the meeting may be considered. Claims which are proved or allowed later must not be considered in determining whether a



majority of creditors has accepted the arrangement.

B. Appropriate Claims Filed Before The  
Close Of The Meeting Were Allowed  
By The Bankruptcy Judge.

It is the judicial act of allowance, not the ministerial act of filing, that is required before a claim may be considered in determining creditor acceptance or non-acceptance of a plan. In re Branner, 9 F.2d 883 (2d Cir. 1925); Bankruptcy Act §362(1).

"Filing has been called the ministerial act of incorporating the proof into the records of the court (as distinguished from the claimant's act of proving and the judicial act of allowing or disallowing a claim). In re Two Rivers Woodenware Co. 199 F. 877 (7th Cir.)." In re Imperial Sheet Metal, Inc., 352 F.Supp. 1149, 1152 (M.D. La. 1973).

Neither the receipt of a claim nor its filing constitutes allowance. Some further judicial order or act is necessary. Hammer v. Tuffy, 145 F.2d 447, 450 (2d Cir. 1944); Monjar v. Higgins, 132 F.2d 990, 994 (2d Cir. 1943); In re Branner, supra; In re Two Rivers Woodenware Co., 199 F. 877, 880-81 (7th Cir. 1912); In re Arcadia Restaurant Co., 19 F. Supp. 355 (E. D. Pa. 1937); In re Tower Magazines, Inc., 16 F. Supp. 894 (M. D. Pa. 1936).

At the continued first meeting of creditors, held on December 20, 1974 before Bankruptcy Judge Seidman, all appropriate claims which had theretofore been filed were allowed. It is allowance which entitles a claim which has



been filed to be considered in determining whether a majority of the creditors have accepted a plan. Thus, when Bankruptcy Judge Seidman said that all claims which had been filed would be counted, he was allowing such claims. (A61 .) There was no objection to this determination that all claims which had been filed were being allowed.

A formal written order of allowance was not required. While mere receipt by the Bankruptcy Judge is not sufficient to constitute allowance, treatment of claims as valid by the Bankruptcy Judge will suffice. Hammer v. Tuffy, supra. Here there was more. There was a judicial determination, without objection, at a creditors' meeting held in open court.

The approval, however, was only of those claims which had already been filed. This was explicit in the ruling of Bankruptcy Judge Seidman. The claims were to be examined so that the Court could "find out what was properly filed", i.e. what had then been properly filed. Claims which had not been filed could not be examined; neither were they within the scope of ruling as to allowance. Such claims were not allowed.

C. The Serico And Mitsubishi Claims Were  
Not Physically Filed With The Bankruptcy  
Court Or The Court Clerk Until After The  
Close Of The Creditors' Meeting.

The Serico and Mitsubishi proof of claim forms were stamped "Received" by the Bankruptcy Court on December 23, 1974. (A79 ; A81 .) Alrac has argued, although there is no evidence



for this in the Record, that these claims were submitted to the Clerk on December 20, 1974. (A404-A405.) This might be significant, since that was the date that the creditors' meeting was closed and the acceptances counted. (A65.) However, counsel for Alrac admitted that the submission to the Clerk's office was done "following the proceedings." (A404.) So that submission could not possibly constitute a filing prior to the close of the meeting.

The other actual presentation to the Bankruptcy Court on which Alrac relies is the purported presence of the claims in the courtroom on December 20, 1974. (Id.; A459.) Not only is there no support for this claim in the Record, on the contrary, the transcript of the proceedings fairly contradicts this claim, that the Bankruptcy Judge accepted as filed claims that were presented to him in the courtroom. (A459.)

At the opening of the meeting on December 20, 1974, Robert Evans, Barnes' counsel, objected to the fact that he had not reviewed the proofs of claims:

"MR. EVANS: No. Before we proceed on this, we haven't seen any proof of claims and obviously the debtor has presented this information. It is the first time we have a chance to see it. I don't know whether or not we can reduce our claim.

"THE COURT: You have that opportunity. They are on file here." (A51.)

It may be noted that the Court did not say that the proofs of claim were on the counsel table.



However, the colloquy continued:

"MR. EVANS: We haven't seen any consents or anything. I don't know where they are.

"THE COURT: What is your -- they haven't filed anything yet.

"MR. KRICK: I have them all here." (Id.)

Here the discussion was not about proofs of claim, but about the creditors' acceptances. As to these, the Court and Mr. Krick were in agreement: the consents had not been filed, but were in Mr. Krick's possession. It is hard to imagine how the distinction could have been made more plain. Certain documents -- the claims -- were "on file." Other documents -- the acceptances -- were not, but were available. Only after the fact was the argument made that the claims were not "on file," but were present and were considered. The record indicates that the documents present but unfiled were consents, not proofs of claims.

This understanding, that the claims being counted were already on file, pervades the transcript of the meeting. Thus Bankruptcy Judge Seidman specifically referred to the relevant claims as being those filed or on file on several more occasions (A56; A58; A61; A62-A63), as did counsel. (A55; A58; A60; A61; A64-A65.) Any claims that may have been present but had not been filed with the Clerk nor presented to the Bankruptcy Judge were clearly not included. (This is not



an admission that there were any claims present, certainly not the Serico and Mitsubishi claims.) Those documents which were present but had not been filed were consents, not claims.

D. The Bankruptcy Judge Correctly Refused  
To Consider Claims Which Were Not  
Docketed On The Claims Register.

At the suggestion of John Krick, Co-Counsel of the Creditors' Committee, the Bankruptcy Court adopted the approach of relying on the docket sheets -- that is, the Claims Register -- of the Bankruptcy Court. (A55 .) The Claims Register is part of the Record on this appeal; relevant pages are reproduced at A84 -A88. This determination by the Bankruptcy Court was made and followed without objection at the creditors' meeting and was put to use by the creditors' committee to reduce the vote opposing the arrangement. Thus it is not subject to attack by Alrac on this appeal.

The Claims Register (referred to at the creditors' meeting as the "docket sheet" or "docket sheets") lists the claims filed with the Bankruptcy Court. This must be distinguished from receipt by the Bankruptcy Court: different stamps are used for the two purposes. The Claims Register refers to date filed, and its entries conform to the "Filed" stamp. (A84 -A88 ; A68 -A83 .)

The Serico and Mitsubishi claims were filed on December 30, 1974, ten days after the creditors' meeting was

closed (A79 ; A81 ; A88 .) Thus, applying the "docket sheet approach" (A55 ), these two claims could not properly be counted.

The reliance on the records of the Bankruptcy Court preceded the explicit adoption of the "docket sheet approach." The "Computation of Vote on Arrangement" (A89 - A105) recites that it is based on a review of the court records. (A89 .) No mention is made of unfiled documents. In fact, the certificate specifies that the "court records" referred to are the "Proofs of Claim." Barnes, his counsel and the Bankruptcy Court were justified in relying on these representations that the Computation of Vote was based on claims which actually appeared in the records of the Bankruptcy Court. The acceptances themselves are not described as court records which were reviewed -- as was made clear at the meeting, the acceptances were not yet court records when the Computation of Vote was prepared. The Computation of Vote was signed by Alrac's counsel. It was countersigned by -- and prepared by -- Mr. Krick. (A64 -A65 .)

The fashion in which the "docket sheet approach" was applied was draconian. There were some creditors who had sent telegrams withdrawing their acceptances. (A57 .) For those of these dissenting creditors whose proofs of claim were docketed, the count of acceptances was reduced. (Id.) However, telegrams were received from two creditors whose proofs of



claim were not listed on the docket sheet. (A57 -A58 .) These creditors, who fervently opposed the plan, were not counted at all. Their claims may have been received, and may have been undergoing the processing between receipt and entry on the Claims Register. But because they were not on the Claims Register at the time the votes were counted, they were not considered at all.

This practice was followed without objection. Since these were telegraphic withdrawals of acceptances, presumably the acceptances had at least been sent. But since the docket sheets were silent, these creditors could not be counted as opposing the plan. The Serico and Mitsubishi claims did not appear on the docket sheets until December 30, 1976 (A88 .) Therefore, they should not have been counted on December 20, 1976. To count them, and reject the claims of non-assenting creditors whose claims also did not appear on the docket sheet, was clearly erroneous.

E. Purported Constructive Receipt By  
Krick Does Not Justify Counting  
These Claims.

In addition to the actual filing described above, Alrac has relied upon constructive filing of the Serico and Mitsubishi claims, pursuant to Bankruptcy Rule 509(c), which provides:

"Error in Filing. A paper intended

to be filed but erroneously delivered to the trustee or receiver, or the attorney for either of them, or to the district judge, referee, or clerk of the district court, shall, after the date of its receipt has been noted thereon, be transmitted forthwith to the proper person. In the interest of justice, the court may order that the paper shall be deemed filed as of the date of its original delivery."

Bankruptcy Rule 509 is inapplicable since Krick is not one of the class of persons referred to therein. In re Gibraltar Amusements, Ltd., 315 F.2d 210 (2d Cir. 1963); In re Dorb the Chemist Pharmacies, Inc., 29 F. Supp. 832, 833 (S.D.N.Y. 1939); In re Brill, 52 F.2d 636, 639 (S.D.N.Y.), aff'd. 52 F.2d 639 (2d Cir. 1931). Krick has not been appointed a trustee. The fact that he is an officer of the Bankruptcy Court as a member of the bar of the Bankruptcy Court is irrelevant. Moreover, Krick failed to comply with Rule 509. He did not note the date of receipt on the papers, and he failed to transmit the claims "forthwith" to the proper person. It is clear that Alrac's contention that Rule 509 applies is an afterthought.

The Bankruptcy Court repeatedly referred to, and inquired about, the filing of claims, as has been shown above. However, Krick repeatedly insisted that the claims on which he relied had been filed. In particular, as to Class I, which is at issue, he began by saying, "There were 58 claims filed for class one." (A58 .) It would not be in the interest



of justice to permit Krick now to rely upon claims which he failed to hand up to the Bankruptcy Court on December 20, 1974.

The contention of appellees that the claims of Serico and Mitsubishi were physically present in the courtroom on December 20, 1974 (A404; A459) is without support in the Record. Krick, for whatever reasons he may have had, did not hand up the claims to the Bankruptcy Judge during the meeting, nor did he submit them to the Bankruptcy Clerk until after the meeting was over. (A84.)

There is no way of knowing from the Record whether or not these claims were physically present, but the obvious inference from the silence of the Record -- and the silence of Mr. Krick -- is that they were not.

The contention that these claims were examined by Barnes and his counsel is without support in the Record and is false. What they examined was the "Computation of Vote on Arrangement," which contained errors on its face and which Krick promised to correct. (A65.) But in that very colloquy, Krick repeated that his girl had counted filed claims. This was false, and misled Barnes, his counsel, and the Bankruptcy Court. It is apparent that in a recess of only 64 minutes, it would be impossible to examine hundreds of claims and acceptances, check for duplicates, and check the arithmetic of the computation. There is not the slightest indication in the Record that all of this was done. On the

contrary, the colloquy after the recess indicates the work performed during that time: an examination of the acceptances and the computation, not of the claims. (A64 -A65 .) Unlike the claims, neither the acceptances nor the computation had previously been available to Barnes in the files of the Bankruptcy Court. (A51 .) Again, it should be noted that there is not a scintilla of evidence in the record that the disputed claims were even in the courtroom, let alone that they were shown to Barnes and his counsel. The clear inference must be to the contrary, in the light of the representations by Krick that he was relying on filed claims, and the undisputed fact that the claims had not actually been filed.

Alrac's reliance on Bankruptcy Rule 509 presents additional difficulties. There is no telling which claims would be within the purview of the Rule if it were applicable. The inclusion of additional claims might bring in the claims as to which Krick was so insistent that "...nothing appears on the docket sheet that refers to those creditors. I Have [sic] checked. I just checked recently." (A57 -A58 ; emphasis supplied.) It might bring in other non-consenting claims. It might also change the classification of creditors. This is exactly what would happen to Edward M. Peters, whose claims are considered below.

Appellees have made no application for an order



under Bankruptcy Rule 509. As has been shown, the conduct of Krick would preclude relief thereunder, even if Krick were within the scope of the Rule, which he is not. To the extent that Bankruptcy Rule 509 applies, its sole effect is to permit relief to be given "In the interest of justice." To apply the ameliorative balm of Bankruptcy Rule 509 to Krick (who is outside its literal bounds) would be to perpetuate a resounding injustice. It was this same Mr. Krick who urged the "docket sheet approach" on the Bankruptcy Court and applied it to reject the telegraphic pleas of other creditors. The interest of justice requires that all creditors be treated with even-handed impartiality. The same treatment should be given to assenters and dissenters alike.

#### POINT II

##### NEITHER OF PETERS' CLAIMS FOR \$18,941.43 SHOULD HAVE BEEN COUNTED

Edward M. Peters [hereinafter "Peters"] was Alrac's Vice President for Marketing. He filed seven claims, numbers 76-79, 240-241 and 274. (A68 -A78 ; A83 .) He was included as a Class I creditor in Alrac's Computation of Vote on Arrangement. (A92.)

Of Peters' claims, the first four, numbers 76-79, were all dated November 25, 1974, stamped "Received" by the Bankruptcy Court on December 4, 1974, and filed on December 6,

1974. (A68 -A75 ; A84 .) Each is in the amount of \$134.82, for a total of \$539.28.

The next two claims, numbers 240-241, were also dated November 25, 1974, and were also received by the Bankruptcy Court on December 4, 1974. (A76 -A78 .) They were stamped "Received" a second time on December 19, 1974. (Id.) There is no evidence in the Record as to the reason for this double receipt. (But see A337; A453 for an explanation.) These claims were filed by the Bankruptcy Court on its Claims Register on December 26, 1974. (A76 -A78 ; A87 .) Claim 240 is in the amount of \$844.26. Claim 241 is in the amount of \$18,941.43. This latter claim was filed by the Bankruptcy Court as a priority claim, as appears from the record prepared by and at the Bankruptcy Court. (A87 .)

Peters' seventh and last claim is number 274, also in the amount of \$18,941.43. (A83 .) This claim was received by the Bankruptcy Court on December 23, 1974 (the same day as the Serico and Mitsubishi claims), and was filed on December 30, 1974 (also the same day as the Serico and Mitsubishi claims, which are numbers 272 and 273). (A79 ; A81 .)

A. The Last Claim Was Filed Too Late.

Every argument against counting the claims of Serico and Mitsubishi applies with equal force against counting Peters' claim 274. It stands on all fours with those claims.



If anything, the fact that it is not dated until the date of the creditors' meeting makes the case against it all the stronger. This claim may not have been executed until after the meeting had been concluded. If it was executed while the meeting was in progress, and was transmitted to the Co-Counsel of the Creditors' Committee, that is all the more reason that it should have been brought to the attention of counsel and of the Bankruptcy Court. But, as has already been shown, Alrac and the creditors' committee carefully failed to disclose the presence of unfiled proofs of claims to the Bankruptcy Court and to Barnes and his counsel. There is no evidence in the record that any such unfiled claims actually were present, and, as has already been shown, the clear inferences are to the contrary.

B. The Priority Claim Should Not  
Have Been Counted.

Claim 241 was a priority claim literally on its face. "Priority" appears on the upper left hand corner. (A78 .) Even more significantly, claim 241 was filed by the Bankruptcy Court as a priority claim (A87 ) and no objection has ever been raised to that determination. Nevertheless, in the District Court, Alrac relied on claim 241 as its basis for counting Peters as a Class I creditor for \$19,480.71 rather than merely \$539.28. (There is no dispute as to the



propriety of counting Peters to the extent of \$539.28.)

It may be that claims 241 and 274 represent duplicates in that they reflect the same underlying claim. Nevertheless, they are both claims, and they were treated differently by the Bankruptcy Court. The non-priority claims should be counted (if at all) as a non-priority claim. The priority claim cannot be counted in determining acceptances, since priority claims are not affected by the plan.

The argument of Alrac that claim 241 is the relevant claim is also refuted by the obvious parallels between claims 272, 273 and 274. If Alrac is relying on the Serico and Mitsubishi claims, why not also on the Peters claim which immediately follows them in sequence. Further support for this analysis arises from Alrac's treatment of claim 240. Alrac's computation of acceptances completely ignored that claim. There is every reason, then, to believe that Alrac treated claim 241 like 240 (ignoring it) while attempting to count claim 274 like claims 272 and 273.

Claim 241 was not filed on the "docket sheets" until December 26, 1974, almost a week after the creditors' meeting at which the Bankruptcy Court adopted the "docket sheet approach." It is clear that if this approach is applied to Peters' claim 241 as it was applied to dissenting creditors, claim 241 cannot be counted.



C. Neither Of The Claims For \$18,941.43  
Should Be Counted In Class I. Either  
Would Put Peters In Class II.

Claim 240, in the amount of \$844.26 (A76-A77), is significant beyond demonstrating Alrac's practices in computing the vote on the arrangement. When added to claims 76-79, it assures that neither of Peters' claims for \$18,941.43 can be counted in Class I. Peters would be a Class II creditor.

The dividing line between Class I and Class II is \$20,000. Creditors with lesser claims are in Class I; larger creditors are in Class II. Peters' claims 76-79 and 240 total \$1,383.54. When either claim for \$18,941.43 is added, the total is \$20,324.97. Thus, if either claim for \$18,941.43 is counted, Peters must be a Class II creditor.

There is no way that either claim for \$18,941.43 can be counted while disregarding claim 240. Claim 240 was executed, received and filed simultaneously with (or ahead of) claim 241. It was executed before, received before and filed before claim 274. Thus neither claim for \$18,941.43 can possibly be a Class I claim. Neither claim should have been counted at all, especially in view of the rigid adherence to the "docket sheet approach" applied to dissenting creditors. But if either claim were counted, it should have been counted in Class II, since Peters' claims would exceed \$20,000.



POINT III

A MAJORITY IN AMOUNT OF  
AFFECTED CLASS I CREDITORS  
DID NOT ACCEPT THE PLAN

Listed on Exhibit II of Alrac's Computation of Vote on Arrangement submitted to the Court on December 20, 1974 (A89-A105) as amended December 23, 1974 (A106-A109; A65) are 13 Class I creditors whose claims exceed \$100 and who did not accept the arrangement. (A93) [The Computation of Vote, as amended, will hereinafter be referred to as the "Computation."] Their claims total \$25,617.93. (There are 8 additional creditors listed in Exhibit II, but they are not affected by the arrangement, since their claims are for less than \$100. Only those creditors whose claims are affected may be considered in determining the majority as to number and amount. Bankruptcy Act §362(1).)

All the claims listed in Exhibit II were filed on or before December 16, 1974. Thus, they were allowed on December 20, 1974 by Bankruptcy Judge Seidman, and were properly included in computing acceptance or rejection.

However, it appears from the Claims Register that there were additional Class I claims which had been filed before December 20, 1974 and thus were allowed before the closing of the creditors' meeting. These include, for example, the four claims of James L. Van Allen for \$134.82 each, filed on December 18, 1974. (A85-A86). Alrac failed



to include these claims in computing the vote on the arrangement although it represented to the Bankruptcy Court and to Barnes and his counsel that it had "reviewed the Court records as of this date" [December 20, 1974]. (A89.) Thus, it is clear that the figure of \$25,617.93 in the Computation is too low. The allowed claims of affected, non-accepting Class I creditors exceeded \$26,000.

Among the claims relied upon by Alrac and the Bankruptcy Court in finding that a majority of the Class I creditors had accepted the arrangement were a claim of Edward M. Peters in the amount of \$18,941.43 and claims of Serico Electric Co., Inc. in the amount of \$5,178.36 and Mitsubishi International Corporation in the amount of \$16,191.25. (A92; A109). As has been shown above, neither the Serico nor the Mitsubishi claim should have been counted. Similarly, neither of Peters' two claims in the amount of \$18,941.43 should have been counted. Moreover, if either claim for \$18,941.43 is counted it must be counted in Class II, since it would make Peters a Class II creditor.

Since these three claims, totalling \$40,311.04, were not eligible to be considered, the Computation, which relied on these claims in determining whether a majority of Class I creditors had accepted the plan, was incorrect. In contrast, for example, to the \$47.18 claim of The Hawley Hardware Co., these three claims are highly significant. They amount to



over 45% in amount of the claims of all Class I creditors compiled in the Computation and over 65% in amount of the acceptances relied upon by Alrac as comprising a majority in amount of the Class I creditors.

Excluding these three claims, the total amount of acceptances relied upon by Alrac is reduced to \$21,702.97. This is substantially less than the amount of non-consenting claims, which exceed \$26,000. Consideration of further errors by the Debtor in excluding non-accepting Class I creditors and including other late or unaffected accepting creditors would only increase the margin of defeat of the plan. While these errors may not be material to the issue of lack of majority in amount, they also reflect on the good faith of Alrac in presenting the Computation.

It is respectfully submitted that both the Bankruptcy Court and the District Court were in error in determining that the arrangement had been accepted by a majority in amount of the Class I creditors whose claims had been filed and allowed. Since a majority in amount of the Class I creditors whose claims had been filed had not actually accepted the arrangement when the creditors' meeting was closed, the arrangement should not have been confirmed. This was not a discretionary matter. The presence of a majority is a matter of arithmetic, and the Class I creditors who did not accept the arrangement were in the majority. To hold otherwise was clearly erroneous.



POINT IV

CONFIRMATION OF THE ARRANGEMENT SHOULD HAVE BEEN DENIED  
SINCE THE PLAN IS NOT FEASIBLE.

If the arrangement is put into effect, the very Order confirming the plan will divest Alrac of its sole asset for all practical purposes, its patent rights. From the annual advance royalties of \$500,000 contemplated by the plan, \$450,000 is committed to payments to creditors into 1987. The actual Purchase Agreement between Alrac and Chevron upon which the plan is predicated was not filed with the Bankruptcy Court, nor is it in the Record either in the District Court or on this appeal. Although Appellant has requested that he be provided with a copy, neither Alrac nor Chevron has ever provided one.

Alrac will be left with a bare \$50,000 per year to operate on. But this is impossible, on the face of the record. Under the plan, Alrac must fail again. It cannot survive on a \$50,000 annual cash flow. Alrac must maintain the patents it has licensed to Chevron, an expense of \$24,000 to \$30,000 per year. With one employee, its chief executive officer, Harvey Wolfe, at an annual salary of \$36,000, Alrac's expenses will exceed its annual income. Meeting additional unavoidable obligations for rent under a new lease (A257), insurance premiums, social security payments, state and federal taxes, will obviously be beyond Alrac's capability.

Alrac will have no capital to use, either. There was \$450,000 received at the closing. (A256; A435). But of this, only \$50,000 to \$100,000 will be available as working capital. (A256.) The rest will go to pay administration expenses and priority claims. (It is little enough. There are two counsel for the creditors' committee and one for Alrac. The patent attorneys are asserting a lien. There are priority claims and other expenses of administration.) But it is this same \$450,000 upon which Alrac relies for operating expenses. (Id.) And that is only for the first year of operations. (Id.)

Where will the money for operating expenses actually come from? There is only one source -- the money Alrac is committing itself to pay to its creditors!

Since Alrac cannot possibly survive without dipping into the funds the plan commits to payments to its present creditors, it is apparent that the arrangement that Alrac has proposed is not feasible. It is so clearly not feasible that it could hardly have been proposed in good faith.

Since the plan is not feasible, it should not have been confirmed by the Bankruptcy Court. Bankruptcy Act §366(2). Neither should such confirmation have been affirmed by the District Court.

At the hearing before the District Court, Alrac's counsel did not dispute a mathematical showing that the plan,



as presented to the Bankruptcy Court in December, 1974, was infeasible. (The demonstration is at A338-A350.) All that he could say was that the intent of the plan was to pay to creditors the monies to be received from Chevron. (A409; A411.)

His actual presentation showed that the plan, which should have been rejected as infeasible in December, 1974, was in worse shape by June, 1975. One ameliorating factor on which he relied was that Alrac intended to resist two large claims. (A374-A375; A409-A410; A411.) One of these claims is for "well beyond a million dollars;" the other is for "\$200,000 or \$300,000." (A375.) But neither of these claims was provided for in the computations on which the plan was based. (A89-A105; A106-A109.) So no reduction in these claims could improve the original feasibility of the plan. On the contrary, unless these claims are not merely reduced (A375) but eliminated, the plan will become even less feasible.

The other factor on which Alrac bases its argument for feasibility is a new line of business its counsel says it has entered. But all that Alrac has to offer here is a speculative hope. (A409-A410.) It has no experience in this new field. (A415.) And of course, Barnes, the inventor whose work led to the Nylon-4 patents, is no longer providing his innovative and technical skills to Alrac.

What was infeasible when the plan was originally presented would seem to be hopeless now. The order confirming the plan should have been reversed, and its affirmance should now be reversed.

POINT V

MODIFICATION OF THE PLAN  
WITHOUT CREDITOR ACCEPTANCE  
OF THE MODIFICATION WAS  
ERRONEOUS.

The arrangement submitted by Alrac to the creditors and the creditors' committee prior to the December 20, 1974 hearing on acceptance contained provisions for issuance of 750,000 shares of the presently authorized common stock of the Debtor to Class II creditors and 750,000 shares of the presently authorized common stock of the Debtor to Class III creditors. (A29; A30.) The plan did not provide for any restrictive legend on the certificates to be issued. (A273.)

On December 26, 1974, after the close of the meeting on acceptance on December 20, 1974, Alrac first proposed a modification of the plan of arrangement pursuant to which the stock certificates to be issued pursuant to the plan would bear a legend restricting their sale, assignment and transfer. (A297-A298.) Although this manifestly affected the creditors who were to receive such certificates, the Bankruptcy Court confirmed the plan without giving notice of such amendment to the creditors nor affording them an opportunity to consider



this modification and withdraw their acceptances. (A273.)

Before Barnes' counsel was permitted to argue in opposition, the Bankruptcy Court said it would find that the amendment could be accepted without giving notice to creditors. It adhered to that view in spite of numerous objections by Barnes' counsel. (A273-A274.) Finally, it cut short such objections by observing that this ruling would provide another basis for appeal, and this is that contemplated appeal. (A275.)

Modification of a plan before confirmation is governed by Bankruptcy Rule 11-39. This provides that:

"If the court finds that the proposed modification does not materially and adversely affect the interest of any creditor who has not in writing accepted it, the modification shall be deemed accepted by all creditors who have previously accepted the plan. Otherwise, the court shall enter an order that the plan as modified shall be deemed to have been accepted by any creditor who accepted the plan who fails to file with the court within such reasonable time as shall be fixed in the order a written rejection of the modification."

The Bankruptcy Court weighed the apparent virtues of the modification against its adverse effect and concluded that the modification would not be prejudicial to the creditors.

(A274.) This it had no power to do. Downtown Investment Ass'n v. Boston Metropolitan Buildings, Inc., 81 F.2d 314, 320 (1st Cir. 1936). The only determination which may be made is

whether there is any material adverse effect. If so, the modification must be submitted to the creditors for their consideration. There is to be no balancing of favorable elements of the modification against objectionable elements. Neither is there any discretionary authority to refrain from submitting a modification to the creditors who have accepted the plan prior to the material modification. Eddy v. Prudence Bonds Corp., 165 F.2d 157, 162 (2d Cir. 1947), cert. denied, 333 U.S. 845 (1948). The issue of materiality and adverseness is not even a question of fact; it is a question of law. Downtown Investment Ass'n v. Boston Metropolitan Buildings, Inc., supra.

The material and adverse impact of the modification was brought to the attention of the court below from the moment the modification was first mentioned. Counsel for Alrac summarized his witness's testimony as being that the stock without the legend would have a value of about fifteen cents. He then observed that with a legend on it, it would drop down to something less than five cents a share if it were sold in volume. (A270.)

Subsequent testimony suggested that the stock with the legend would be worth "virtually nothing. . . maybe a penny or something." (A293.) And if the stock with the legend sold in smaller lots, the legend would still result in a 50% reduction from the bid side [the transcript reads



"bedside"] of the market, perhaps from twelve and a half cents bid to six and a quarter. (A294.)

This substantial decrease in value was a material adverse consequence to all Class<sup>I</sup> II and Class III creditors. Yet such creditors were denied any warning of this modification of the plan. They accepted a plan in which they would receive unrestricted Alrac stock. The plan, as confirmed, gives them stock which, by Alrac's own witness's testimony, is worth only half as much.

Whether there would be a limitation of transferability of the newly issued shares absent a legend is not an issue on this appeal. If there is no such limitation, the legend does not impose one, since it specifies that the shares may be freely transferred if an exemption from registration is, in fact, available. Conversely, if no exemption is available, it is not the legend but the Securities Act of 1933 that imposes the restriction on transferability.

What is at issue on this appeal is the effect on the plan of the modification which specified that the legend appear on the stock. This imposed no new restriction on the stock, but it did affect the value of the stock. The effect of the modification was not to restrict the stock, but to halve its value. It is this modification of value which was never submitted to the creditors. The creditors had been expecting to receive stock which bore no legend and had some

value. They are now to receive stock with only half that value. The modification which had this effect was material, and should have been submitted to the creditors to permit them to re-evaluate their acceptance of the plan.

The purported benefit to the creditors of Alrac arising from the commitment to register the stock constituted still another material modification of the plan, as to which the creditors should have been consulted, but were not. While this modification will arguably benefit some creditors who might wish to sell the stock, it will unquestionably materially and adversely affect all creditors as creditors. This commitment will be a drain on Alrac's resources, resources that are already over-committed several times over.

Creditors who are to receive Alrac's notes will be adversely affected to the extent that the plan is modified to impose additional obligations upon Alrac. They should not be precluded from considering the modification to the plan on the grounds that these additional obligations may redound to their benefit as stockholders. The balance is for the creditors to strike, not for the Bankruptcy Court. Downtown Investment Ass'n. v. Boston Metropolitan Buildings, Inc., supra.

The commitment to register may be of benefit to some creditors, namely those who are concerned with the stock "kicker" they are receiving. But other creditors will feel



the greater concern over the security of their Alrac debt obligations. These creditors will be displeased at a modification which requires that Alrac's resources be expended for a registration which will redound to stockholders' benefit. These creditors are entitled to the benefit of the notification and rejection provisions of Bankruptcy Rule 11-39.

It was for the Bankruptcy Court to determine, as a matter of law, whether or not restricting the sale, assignment or transfer of the stock constituted a material adverse modification to the original plan, which had imposed no such restrictions. Similarly, the Bankruptcy Court had to determine whether imposing the registration obligation upon Alrac would constitute a material modification, adverse to the interests of any creditor. It is respectfully submitted that it was error to rule that, as a matter of law, neither change had any material adverse effect upon any creditor.

#### POINT VI

#### CHAPTER X, RATHER THAN CHAPTER XI, IS THE APPROPRIATE PROCEEDING

#### A. The Arrangement Realigns The Rights Of Investors, Rather Than Merely Adjusting The Rights Of Trade Creditors.

A material aspect of the proposed plan of arrangement is the issuance of 1,500,000 shares of the Debtor's common stock to Class II and Class III creditors without any



contribution to capital by the recipients thereof. The equity of existing stockholders would thus be reduced by slightly less than fifty percent. Thus, an element outside of the competency of a Chapter XI was crucial to the purported arrangement. Sec. 306(1) of the Bankruptcy Act limits the effect of an arrangement to settlement, satisfaction or extension of time of payment of the debtor's unsecured debt.

If a question existed at any time as to whether there was a need for more than a simple readjustment of unsecured debt, the arrangement submitted by Alrac and accepted by the creditors' committee has furnished an affirmative answer.

Securities and Exchange Commission v. U.S. Realty & Improvement Co., 310 U.S. 434 (1940) initially laid down the rule that as a general matter, Chapter X is the appropriate proceeding for readjustment of publicly held debt. In 1965, again facing the question of whether a Chapter X or a Chapter XI was the appropriate proceeding, the Supreme Court, while rejecting the SEC's contention that Chapter X is required in all cases involving public investor creditors, reaffirmed its ruling in U.S. Realty, supra, that "as a general rule Chapter X is the appropriate proceeding for adjustment of publicly held debt." Securities and Exchange Commission v. American Trailer Rentals, 379 U.S. 594, 613 (1965). The Supreme Court, in explaining the rationale of the rule, ob-



served at p. 614:

"It seems clear that in enacting Chapter X Congress had the protection of public investors, and not trade creditors, primarily in mind. As noted above, Chapter X is one of many Acts in which the SEC has the statutory right and responsibility to protect public investors. Finally, again it is clear that Congress was thinking of Chapter XI as primarily concerned with adjustment of the rights of trade creditors when it deemed the 'fair and equitable' doctrine to be unnecessary to 'simple' compositions in Chapter XI." (Footnotes omitted.)

It is apparent that the arrangement contemplates an adjustment of the equity interest in Alrac as well as an extension of Alrac's time to satisfy its trade obligations. As was observed in In the Matter of Arlan's Department Stores, Inc., 373 F. Supp. 520, 524 (S.D. N.Y. 1974):

"Where the rights of public investor creditors are to be adjusted in more than a minor way, the safeguards and procedures of Chapter X are required. [Citations.]"

The consideration of the basic issue presented to the Bankruptcy Court on Barnes' motion to transfer to a Chapter X was considered by this Court in Securities and Exchange Commission v. Canandaigua Enterprises Corp., 339 F.2d 14 (2d Cir. 1964) which found the greater protection afforded in a Chapter X to be necessary where the rights of stockholders, the debtor, public debt and trade creditors were to be necessarily affected.



B. A Pervasive Review Of Management And  
The Corporate Structure Available Only  
Under Chapter X Is The Primary Need  
To Be Served.

The Bankruptcy Court considered the question of whether need existed for an examination of Alrac's management, but disposed of the issue on the irrelevant premise that Barnes, the appellant, had been a central figure in such management only a month before filing of the Chapter XI petition. Both the Bankruptcy Court and the District Court overlooked the need for an examination of current management (or mismanagement).

It is apparent that Barnes has been out of control of Alrac for over two years, and that the present management has been engaged in very different activities from those in which he engaged or would have engaged.

Although Barnes participated in the negotiations with Chevron which culminated in the April, 1974 agreements and even signed the agreements as president of Alrac, he opposed them, but had been outvoted by the board of directors. These facts are also findings of the Bankruptcy Judge, based on oral testimony given before him. (A301; A183-A185; A193-A194.) From the time those agreements were signed, Chevron dominated Alrac, and Barnes was no longer influential. A measure of Chevron's domination may be seen in the confusion that has arisen over Barnes' opposition to the April agreements and his signing as president at the behest of the



board of directors which had outvoted him.

The fact of Barnes' opposition is not disputed by any witness, and has been admitted by both Alrac and Chevron. Nevertheless, doubt has been raised by a statement in some purported corporate minutes that the approval of the agreements by the board of directors was unanimous. These purported minutes were in the possession of Chevron and were produced by its counsel, Mr. Miller. (A189.) On the other hand, although these were minutes of meetings of Alrac's board of directors, Alrac could not produce them. (A191.)

From then on, Chevron completely dominated Alrac. It supplied the money and dictated Alrac's corporate acts. When Alrac's stockholders and creditors (including Barnes) would not ratify the April agreements, Chevron chose to resort to the courts. Agreements were drafted and executed which required court approval within five days of the submission of a petition. While the deadline was extended by Chevron, the total time permitted for judicial evaluation before Chevron's final deadline was only eleven business days.

The present proceedings were compelled by the agreements entered into by Alrac and Chevron in August, 1974. Barnes' independent action was independent of that Chevron transaction, which necessarily resulted in the Chapter XI proceeding. (A378.)



The management of Alrac, no longer including Barnes, had obtained invulnerable control. Stockholder meetings had not been held, and no stockholder approval was obtained for any of the Chevron agreements. The present management has used the pendency of these proceedings to preclude any stockholder control while these proceedings are under way. Instead, it has engaged in undertakings completely different from Alrac's prior activities. Only a transfer to Chapter X can provide a pervasive review of the management of this corporation.

It is apparent that the "pervasive reorganization" issue existing in Canandaigua Enterprises Corp., supra, is here present. As was observed in In the Matter of Arlan's Department Stores, Inc., supra, at p. 524:

"My discretion is limited to a factual determination of whether the debtor needs a pervasive reorganization rather than a simple composition of unsecured debts. (Citation) Once that question is decided, then the guidelines established by the Supreme Court on the proper chapter to proceed under must be followed."

It is respectfully submitted that the discretion of the Bankruptcy Court and the District Court was similarly circumscribed and that the record clearly demonstrates the need for such pervasive reorganization. The arrangement proposed by Alrac itself constitutes a pervasive reorganization of Alrac's equity structure, relegating the former stockholders as such to a minority interest.



C. Application Of The Fair And Equitable  
Test Available Only Under Chapter X  
Is Required.

In the arrangement here proposed, Class I creditors will receive \$100.00 or 15% of their claim, whichever is greater. Although the "fair and equitable" requirement has been deleted from Chapter XI, that requirement under Chapter X should be considered when evaluating a motion to transfer to Chapter X. In General Stores Corp. v. Shlensky, 350 U.S. 462, 466-67, the Supreme Court enunciated several typical instances where Chapter X affords a more adequate remedy than Chapter XI, thereby precluding the use of the latter Chapter. The first of these was stated to be where:

"Readjustment of all or a part of the debts of an insolvent company without sacrifice by the stockholders may violate the fundamental principle of a fair and equitable plan (see Case v. Los Angeles Lumber Products Co....) as the United States Realty Co. case emphasizes." Id. at 466.

This statement in General Stores refers to the requirement that a plan of reorganization under Chapter X involving readjustment of the debt structure must be "fair and equitable." These are "words of art" requiring conformity to the absolute priority rule, which means:

"that in any plan of corporate reorganization unsecured creditors are entitled to priority over stockholders to the full extent of their debts and that any scaling down of the claims of creditors without some

fair compensating advantage to them which is prior to the rights of stockholders is inadmissible." U.S. Realty Co., 310 U.S. at 452.

Applied to the facts of this case the absolute priority rule would mean that the Class I creditors must receive the full amount of their claims before stockholders can participate or gain any advantage. The proposed plan would involve the continuance of the interests of a junior class, the common stockholders, while sacrificing the claims of Class I creditors.



CONCLUSION

The judgment of the District Court should be reversed and the case remanded to the District Court with instructions to reverse the orders of the Bankruptcy Court and remand the case to that Court for further proceedings under Chapter X, or if the denial of the motion to transfer to Chapter X is sustained, for further proceedings under Chapter XI.

Respectfully submitted,

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UNITED STATES DISTRICT COURT FOR THE  
DISTRICT OF CONNECTICUT

-----X  
In the Matter of

ALRAC CORPORATION f.d.b.a.  
RADIATION RESEARCH CORPORATION  
f.d.b.a THE ALRAC COMPANY,

Debtor,

CARL E. BARNES,

Appellant,

v.

ALRAC CORPORATION,

Debtor-Appellee.  
-----X

STATE OF NEW YORK )  
: ss.:  
COUNTY OF NEW YORK )

RICHARD L. SCHMEIDLER, being duly sworn, deposes and  
says:

I am not a party to the action, am over 18 years of  
age, reside at One Fifth Avenue, New York, New York and am a  
member of the bar of this Court.

On June 10, 1976, I served a true copy of the annexed  
Joint Appendix and two copies of the Appellant's Brief by mailing  
same in a sealed envelope, with postage prepaid thereon, in a  
post-office within the State of New York, addressed to the last  
known address of the addressees as indicated below:

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Docket No.  
76-5014

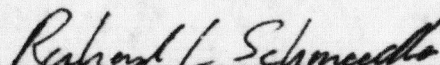
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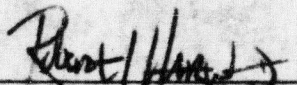
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RICHARD L. SCHMEIDLER

Sworn to before me this  
10 day of June, 1976.

  
Notary Public

ROBERT L. HARWOOD  
Notary Public, State of New York  
No. 03-4602705  
Qualified in Bronx County  
Commission Expires March 30, 1978